SUPREME COURT, U. S.
MAY 29 1961
JAMES R. BROWNING, Clerk

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 196[illegible]

No. [illegible] 170

JOHN W. CHAMBERLIN and
MARIAN McMICHAEL CHAMBERLIN,
Plaintiffs-Petitioners,

v.

UNITED STATES OF AMERICA,
Defendant-Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

HARVEY W. PETERS
1308 North Prospect Avenue
Milwaukee 1, Wisconsin
Counsel for Petitioners

HAMMERSMITH-KORTMEYER CO. MILWAUKEE

INDEX

Page

Opinions Below 2

Jurisdiction 2

Questions Presented 2

Statutes and Ruling Involved 4

Statement of the Case 4

Reasons for Granting the Writ 11

I. The Lower Court Decision Is In Specific and Direct Conflict with Several Decisions of the United States Supreme Court and Several Decisions of Circuit Courts of Appeal.. 11

II. A Decision by the United States Supreme Court Is Required to Reaffirm the Long Standing Rule that Speculative Contract Rights Are Not the Equivalent of Cash for Income Tax Purposes 14

III. The United States Supreme Court by Deciding the Instant Case Will Dispel the Confusion and Will Terminate Continued Litigation on Matter of Whether the Estimated Value of Contract Rights Requiring Contingent and Uncertain Future Payments Has Any Bearing in the Treatment of the Receipt of Such Contract Rights for Income Tax Purposes 20

IV. A Decision of the United States Supreme Court Would Dispel the Conflict and Con-

Page

fusion Caused by the Lower Courts Holding in Another Issue in the Instant Case 23

Conclusion 25

Appendix A

Opinion 27

Judgment 37

Order Denying Petition for a Rehearing..... 38

Appendix B

Statutes 39

Ruling 42

AUTHORITIES CITED

Andrews v. Commissioner, Curtis R., 23 T.C. 1026 18

Automotive Products Corporation v. Wolverine Bumper & Specialty Co., et al, 15 F. 2d 745 24

Bedell v. Commissioner, 2 Cir., 30 F. 2d 622, 7 A.F.T.R. 8469 12

Boudreau v. Commissioner, Robert J., 5th Cir., 134 F. 2d 360 .....17, 18

Burnet v. Logan, 283 U.S. 404, 51 S. Ct. 550 .....11, 12, 14, 15, 18, 21

Cassatt v. Commissioner, 137 F. 2d 745 18

Commissioner v. Carter, 2 Cir., 170 F. 2d 911, 37 A.F.T.R. 573 12

Page

Commissioner v. Darnell, Inc., 6 Cir., 60 F. 2d 82 ... 12

Commissioner v. Thompson, 222 F. 2d 893, 47 A.F.T.R. 959 ... 16

Cowden, et al v. Commissioner, Frank Sr. and Gladys, 32 T.C. No. 73 ... 17

Deering v. Commissioner, Willis R., 36 B.T.A. 843 21

Edwards Drilling Company v. Commissioner, 35 B.T.A. 341 ... 21

Ennis v. Commissioner, Nina J., 17 T.C. 465 ... 18

Gersten, et al v. Commissioner, Albert, 28 T.C. 756 16

Goldsmith v. Commissioner, Albert J., 22 T.C. 1137 25

Hatch v. Commissioner, May D., 14 T.C. 237 ... 16

Hill's Estate, et al v. Maloney, 58 Fed. Supp. 164, 33 A.F.T.R. 479 ... 16

Hoy v. Commissioner, Frank H., T.C. Memo 1958-28 ... 23

Hurlburt, Deceased, v. Commissioner, Estate of Coid, 25 T.C. 1286 ... 19

Lentz v. Commissioner, George J., 28 T.C. 1157 ... 22

LeVay v. Commissioner, Edward Allen, Jr., T.C. Memo 1960-263 ... 19

Lloyd v. Commissioner, J. Darsi, 33 B.T.A. 903 ... 22

Loewi & Co. v. Commissioner, 7 Cir., 232 F. 2d 621, 49 A.F.T.R. 958 ... 13

Lucas v. American Code Company, Inc., 280 U.S. 445, 50 S. Ct. 202, 8 A.F.T.R. 10278 ... 13

Page

Megargel v. Commissioner, Margery K., 3 T.C. 238.. 25

National Pigments & Chemical Company v. C. K. Williams & Co., 94 F. 2d 792 24

North American Consolidated v. U. S., 286 U.S. 47, 52 S. Ct. 613, 11 A.F.T.R. 16 13

O'Brien, et al, Petitioners v. Commissioner, Pat, 25 T.C. 376 15

Osenbach v. Commissioner, Mace, 17 T.C. 797, affirmed 4 Cir., 198 F. 2d 235, 42 A.F.T.R. 355.... 16

Peck, et al v. Commissioner, Lee H., 1952 T.C. Memo Decision 6/26/52 22

Perry v. Commissioner of Internal Revenue, 8 Cir., 152 F. 2d 183, 34 A.F.T.R. 560 17

Platt v. Fire Extinguisher Mfg. Co., 59 F. 2d 897.... 24

Reid v. Commissioner, Rose Marie, 26 T.C. 622.... 25

Simms v. Commissioner, E. F., 28 B.T.A. 988 21

Warren v. U. S., 171 F. Supp. 943, 3 A.F.T.R. 2d 1108 .....16, 17

Westover, et al v. Smith, 9 Cir., 173 F. 2d 90, 37 A.F.T.R. 1001 12

STATUTES CITED

Internal Revenue Code of 1939

Section 117 (26 U.S.C. 117—1952 Ed., Volume 3, page 3372) 4, 8

RULING CITED

Revenue Ruling 58-402, Cum. Bull. 1958-2, Page 15 .....4, 14, 15, 17, 18, 22

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1960

No.

JOHN W. CHAMBERLIN and
MARIAN McMICHAEL CHAMBERLIN,

Plaintiffs-Petitioners,

v.

UNITED STATES OF AMERICA,

Defendant-Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners, John W. Chamberlin and Marian McMichael Chamberlin, petitioners-appellants in the Courts below, pray that a Writ of Certiorari issue to review the judgment herein of the United States Court of Appeals for the Seventh Circuit.

Said judgment, affirming the Tax Court of the United States' decision and judgment, was entered on November 30, 1960 and the opinion of the Court was released on November 30, 1960. Thereafter petitioners did, on December 14, 1960, file with the United States Court of Appeals for the Seventh Circuit a Petition for Rehearing. On March 20, 1961 the Petition for Rehearing was denied by the United States Court of Appeals for the Seventh Circuit, and its order of denial was entered March 20, 1961.

OPINIONS BELOW

The Findings of Fact and Opinion of The Tax Court of the United States is reported at 32 T.C. 1098 and is printed in the record below (Record 4a-36a). The opinion of the United States Court of Appeals for the Seventh Circuit (Appendix A, infra, pp. 27-36) is reported at 286 F. 2d 850 (U.S.C.A. 7), and its Order denying petitioners' Petition for Rehearing is reported at 286 F. 2d 850 (U.S.C.A. 7).

JURISDICTION

The judgment of the Circuit Court of Appeals for the Seventh Circuit was dated and entered November 30, 1960, petition for rehearing was filed December 14, 1960 and denied by the Appeals Court Order entered March 20, 1961. The jurisdiction of the Court is invoked under 28 U.S.C. 1254(1) and 28 U.S.C. 2101(c).

QUESTIONS PRESENTED

(1) Do rights in a speculative patent license providing for uncertain and contingent future payments have an ascertainable value for purpose of determining receipt of income under the 1939 Revenue Code?

(2) Is there a different legal conclusion as to the ascertainable value of speculative contract rights for income tax purposes in case the rights are received in exchange for shares of stock, and where capital gain treatment may result as to payments received under the speculative rights in years subsequent to the exchange?

(3) In case of receipt of speculative contract rights in exchange for shares of stock must the value of the rights be estimated so as to close the transaction for tax purposes in the year of exchange?

(4) Instead, are such speculative contract rights deemed to have an unascertainable value for income tax purposes, so as to keep the exchange transaction open until future year payments are received, with each payment constituting proceeds from sale of the shares originally exchanged?

(5) Where shares of stock are a capital asset held for more than 6 months, and the shares are exchanged for speculative contract rights, do the payments thereafter received under the rights qualify as proceeds from sale of a capital asset held for more than 6 months under Section 117(a) and (b) of the 1939 Revenue Code?

(6) Where the payments under contract rights are received by a wife, who received the contract rights by gift from her husband, do the payments have the same taxable character upon receipt by her as in case of her husband?

(7) Does the reinstatement of a cancelled exclusive license agreement constitute a sale and assignment of the patentable interest thereunder for income tax purposes under the 1939 Revenue Code?

(8) Where a taxpayer had acquired a portion of the rights to payment under an exclusive license agreement, and joined in cancelling the license for default on part of the licensee, and thereafter reinstated the license at a time when she had acquired all possible rights, including reversionary rights, with a period of over 11 months intervening between cancellation and reinstatement, did the taxpayer effect a sale or exchange of a patentable interest held for more than 6 months?

(9) Are the payments thereafter received by the taxpayer, after reinstatement of the exclusive license, entitled to long-term capital gain treatment under Section 117 of the 1939 Code, where said taxpayer is not in the trade or business of selling patentable interests?

STATUTES AND RULING INVOLVED

The statutory provisions involved are Section 22(a) of the Internal Revenue Code of 1939 (26 U.S.C. 22(a)—1952 Ed., Volume 3, page 3296), and Section 117 of the Internal Revenue Code of 1939 (26 U.S.C. 117—1952 Ed., Volume 3, page 3372); and the ruling involved is Revenue Ruling 58-402 (Cum. Bull. 1958-2, page 15), all of which are set forth in Appendix B, infra, pp. 39-47.

STATEMENT OF THE CASE

The controversy involves the question of capital gain allowance as to payments received by petitioners under two different situations, in each case involving payments received under exclusive license agreements covering patentable interests.

In the proceedings before the Tax Court, the facts were stipulated in part, and other facts were introduced at trial. Joint exhibits and individual party exhibits were also introduced at trial. The Tax Court made findings of fact and found the stipulated facts as stipulated. (Record 8a-17a). The facts as stipulated and found may be summarized as follows:

Petitioners were husband and wife for the years at issue, with their residence at 809 Brummel Street, Evanston, Illinois. Petitioners filed separate returns for 1947, and joint returns for the years 1948 and 1949. Both petitioners reported their income for all years on a calendar year, cash basis, of accounting.

Briefly stated, the one issue involves royalty payments received under contract rights from Bendix Home Appliance, Inc. by both petitioners. In case of petitioner

John W. Chamberlin, he received the payments under contract interests that he had received in exchange for stock held for more than 6 months prior to the exchange. In case of petitioner Marian McMichael Chamberlin, she received the same type payments on contract interests that her husband had received in the aforesaid exchange of stock, and which contract interests he then transferred to her by gift. The other tax issue concerns payments received by Marian McMichael Chamberlin from Borg-Warner Corporation under an exclusive patent license that she had reinstated after it had been cancelled more than 11 months prior to the reinstatement.

The petitioners claim that both types of patent royalty payments represent the receipt of long-term capital gain income. As to the 1947 payments from Bendix, both petitioners reported the royalty payments as ordinary income, but thereafter duly filed Claims for Refund on basis that the payments were long-term capital gain income. The payments received from Bendix for 1948 and 1949 were originally reported as long-term capital gains. As to the payments received by Marian McMichael Chamberlin from Borg-Warner Corporation, such payments were received in 1948 and 1949, and reported as long-term capital gain income for income tax purposes.

The respondent claims that both types of royalty payments were taxable to petitioners as ordinary income, and The United States Tax Court so determined. Upon appeal, the Circuit Court of Appeals for the Seventh Circuit affirmed the decision of The United States Tax Court.

There are three separate cases, but they were consolidated for purpose of trial and filing of briefs in the Tax Court. The findings of fact and opinion of the Tax Court determined the issues for the three cases.

Each particular issue will be briefly summarized under an appropriate heading.

Royalty Payments from Bendix Home Appliances, Inc.

Petitioner, John W. Chamberlin, on July 17, 1936, obtained a 20 percent interest in and to any royalties that might be payable to Laundri-Matic Corporation by Hydraulic Brake Company with the understanding that he would turn into Laundri-Matic 20 percent of the shares of said Corporation owned by him. (Record 9a). Later, on December 4, 1937, Chamberlin received an additional assignment of a 6 percent of the aforesaid royalties payable under the Hydraulic license (Record 11a) and on December 7, 1937 Chamberlin transferred the 26 shares (26 percent) of his Laundri-Matic stock to the Corporation (Record 11a). Also, on December 7, 1937 Chamberlin assigned to Marian the 6 percent interest in royalties as obtained by him on December 4, 1937 (Record 12a). Although the assignment to Marian stated that he was to receive $5.00 consideration, no consideration was in fact paid, and the transfer of the 6 percent royalty interest to Marian was a gift (Record 12a).

Subsequent to such assignments, the contract between Hydraulic Brake Company and the Laundri-Matic Corporation was assigned to, and assumed by, Bendix Home Appliances, Inc., the payor of the royalties here at issue (Record 12a). In brief, Chamberlin turned in his stock to Laundri-Matic for a proportionate interest in the royalty (license) contract, and transferred a part thereof (6 percent) to his wife, Marian, as a gift.

The patent license under which Chamberlin was assigned royalty rights was not yielding royalty payments

at time of assignment. In fact, the license required that certain prior steps be taken before any sales of the invented article could be made on which royalties would be payable. Such steps included:

> Hydraulic would develop, test and exploit the inventions (par. 2) (Record 59a).
>
> Hydraulic agreed to bear expense of further development of said domestic laundry machines, and agreed to employ two engineers to assist in such development (par. 3) (Record 59a).
>
> Laundri-Matic was to designate an agent, satisfactory to Hydraulic, to secure a manufacturer of the laundry machines (par. 6) (Record 61).

Said provisions clearly indicate the speculative nature of future payments, if any, under the license and the rights thereunder obtained by Chamberlin in exchange for the shares of stock.

Both petitioners claim that the payments received from Bendix are the proceeds from the sale of the Laundri-Matic shares by John W. Chamberlin. They claim that at time of the exchange of his shares for the contract interests he was receiving rights in a speculative patent license providing for uncertain future and contingent payments, and that such contract rights did not have an ascertainable value sufficient to close the matter for income tax purposes. Accordingly, petitioners claim that as subsequent payments were received under the contract rights, such payments were proceeds of the shares transferred in exchange for the contract rights. Since the shares were held for more than six months prior to the exchange, and since the shares were a capital asset, Mr. Chamberlin not being in the business of selling shares of stock,

there was a sale of a capital asset held for more than 6 months. Petitioners claim the payments when received are proceeds from sale of a capital asset held for more than 6 months, and should be taxed as a long-term capital gain under Section 117(a) and (b) of the 1939 Revenue Code.

Marian McMichael Chamberlin claims payments from Bendix are entitled to the same tax treatment as in case of her husband, since she received the contract rights by gift from her husband.

The Tax Court rejected petitioners' contention that speculative contract rights legally have an unascertainable value for income tax purposes. The Court erroneously concluded that the question involved one of estimated value of the contract rights, and proof that the value of the rights was unascertainable based upon any estimates as to value. Accordingly, the Tax Court concluded that the exchange of shares of stock for the speculative contract rights was a closed transaction in the year of the exchange, so that all subsequent payments were not the proceeds of sale, but were payments under the contract rights, and were ordinary income. Although the Tax Court accepted the contention that the payments to Mrs. Chamberlin had the same taxable character as in case of her husband, the Tax Court decision as to the ordinary income status of payments received by the husband resulted in Mrs. Chamberlin's payments being considered ordinary income. The Circuit Court of Appeals for the Seventh Circuit affirmed the decision of the Tax Court in all respects, and denied a Petition for Rehearing.

Royalty Payments from Borg-Warner Corporation

Chamberlin-Bassett Research Corporation held certain patents or patentable interests, and in February 1939 had granted an exclusive license to Borg-Warner Corporation as to such patentable interests. Chamberlin-Bassett Research Corporation could terminate the license upon thirty days' notice in event of Borg-Warner's failure to pay royalties, or otherwise comply with the License Agreement (Record 83a-95a).

By agreement dated March 13, 1939, Research Corporation assigned to Chamberlin and Bassett each a 50 percent interest in and to all royalties paid by Borg-Warner Corporation under the aforesaid license (Record 51a).

By assignment dated August 25, 1940, Chamberlin sold to Marian all rights he held to receive royalities under the license between Research and Borg-Warner (Record 51a). Prior to April 17, 1943 an attorney for Marian purchased for her from Bassett his right to receive 50 percent of the royalties payable under the Borg-Warner license, which rights the attorney transferred to Marian (Record 118a).

Marian McMichael Chamberlin had acquired 100 shares of Research Corporation stock on or about time of incorporation, and on December 5, 1939 Marian purchased her husband's 400 shares of Research stock, and in June 1940 Marian purchased the 500 shares owned by Bassett and his wife, and thereafter Marian Chamberlin was the sole stockholder of Research, owning all of the 1,000 shares outstanding (Record 50a-51a).

By corporate resolution of June 17, 1940, Research Corporation authorized Chamberlin and Marian to sell

any assets of the Corporation, but Research Corporation was not formally dissolved even though essentially all of the assets of Research were disposed of during the year 1940, with only the "shell" remaining by the middle of 1941 (Record 135a, 140a, 144a) at which time Marian Chamberlin was the sole (100%) stockholder of Research Corporation.

By letter of February 28, 1942, Research Corporation and Marian notified Borg-Warner Corporation of an intention to cancel the license for default in payment of royalties and other conditions of the contract. The attorney for Marian had informed her that Borg-Warner was in default. Borg-Warner denied that it was in default under the license agreement (Record 110a).

By letter notification dated April 22, 1942 Borg-Warner was informed of the termination of the license agreement (Record 52a and 110a).

Negotiations were conducted from April 1942 until April 1943 between Borg-Warner and the attorney for Marian respecting license contract cancellation (Record 110a-113a). During the same period, attempts were made to sell the patent rights to parties other than Borg-Warner (Record 134a).

On April 17, 1943 the dispute between Borg-Warner and Marian was settled by letter agreement providing that the cancelled license agreement would be in full force and effect, and that any notices for cancellation and breach of contract were premature and ineffective, and payment for the minimum royalties from April 1, 1943 to April 1, 1944 were paid to Marian, and thereafter all payments under the License Agreement were made to Marian.

As to this issue, Marian contends that there was a cancellation and termination of the Agreement between Research Corporation and Borg-Warner Corporation, that she, as the sole stockholder of Research, had received all of the assets, including any reversionary patent rights flowing to the Corporation by cancellation of the Agreement, and further, that on April 17, 1943 she had effected a sale of the patent rights to Borg-Warner by reinstating the Agreement. Marian was not in the business of selling patents, inventions, or patentable interests, and accordingly the proceeds of the sale received by Marian from Borg-Warner Corporation represented the proceeds from the sale of a capital asset held for more than six months.

In essence, The United States Tax Court decided this issue by determining that the payments were not received by Marian as the result of the sale or exchange of a capital asset, because the parties (licensor and licensee) retained the same rights and obligations they had before the notice of cancellation, and the Court concludes that the payments were received as a collection from royalties due, and hence the royalty payments were taxable as ordinary income. The Circuit Court of Appeals for the Seventh Circuit affirmed the Tax Court decision as to this issue also, and denied a Petition for Rehearing.

REASONS FOR GRANTING THE WRIT

I. The Lower Court Decision Is In Specific and Direct Conflict With Several Decisions of the United States Supreme Court and Several Decisions of Circuit Courts of Appeal.

The United States Supreme Court in *Burnet v. Logan*, 283 U.S. 404, 51 S. Ct. 550, decided that a contract requiring future contingent and uncertain payments

could not be said to have an ascertainable value for income tax purposes based on conjectural market value. In this particular case the market value of the rights had been determined by experts, and the market value had been determined for Federal Estate Tax purposes. The Supreme Court decided that the income tax law affects only realized losses or gains, and that a promise to pay indeterminable sums in the future does not involve realized taxable income. The Supreme Court concluded that such situation did not demand that an effort be made to place a market value upon a contract for future payments according to the best available data.

The Supreme Court also decided that receipt in a sale or exchange of a contract calling for uncertain and indefinite payments required a completion of payments, rather than speculative estimates as to probable payments, and that the payments under the contract would be taxable when received.

The United States Supreme Court decision in *Burnet v. Logan* has been consistently followed in the decisions of several Circuit Courts of Appeal respecting receipt of contract rights calling for indefinite future payments, including the following:

Westover, et al v. Smith, 9 Cir., 173 F. 2d 90; 37 A.F.T.R. 1001.

Commissioner v. Carter, 2 Cir., 170 F. 2d 911, 37 A.F.T.R. 573.

Bedell v. Commissioner, 2 Cir., 30 F. 2d 622, 7 A.F.T.R. 8469.

Commissioner v. Darnell, Inc., 6 Cir., 60 F. 2d 82.

The legal conclusions on point that contract rights calling for uncertain and contingent future payments need

not be valued at time of receipt for income tax purposes is premised upon the sound legal fundamental that the income tax law is concerned only with realized losses as with realized gains. This legal premise has been sustained in a long list of cases including:

> *Lucas v. American Code Company, Inc.*, 280 U.S. 445, 50 S. Ct. 202, 8 A.F.T.R. 10278.
>
> *North American Consolidated v. U.S.*, 286 U.S. 47, 52 S. Ct. 613; 11 A.F.T.R. 16.
>
> *Loewi & Co. v. Commissioner*, 7 Cir., 232 F. 2d 621, 49 A.F.T.R. 958.

Despite the impressive array of court authorities to the contrary, the United States Court of Appeals for the Seventh Circuit accepted the Tax Court view in the instant case that —

> " * * * There is nothing inherent in a contract or claim for the future payment of indefinite amounts that causes it to be insusceptible of valuation."

The Appeals Court then also accepted the Tax Court conclusion that —

> "We cannot conclude as a matter of either fact or law, on the basis of the terms of the license agreement alone, that the value of the right to receive a percentage of the future royalties to be paid thereunder could not have been ascertained in 1936 and 1937."

Under the cases herein cited, a contract calling for possible future contingent and uncertain payments has an unascertainable value for income tax purposes as a matter of law. Further, the rule of certainty required by the income tax law provides that payments under such contract rights become income only when received. Fi-

nally, if the contract rights were received in a sale or exchange, payments subsequently received represent the proceeds from the sale or exchange under which the contract rights were received.

II. A Decision by the United States Supreme Court is Required to Reaffirm the Long Standing Rule That Speculative Contract Rights are Not the Equivalent of Cash for Income Tax Purposes.

Speculative contract rights are not the equivalent of cash for income tax purposes. Such has been the long standing rule since *Burnet v. Logan*, 283 U.S. 404, 51 S. Ct. 550. In technical terminology such contract rights have been held to have an unascertainable value.

The lower courts in the instant case completely missed the point that speculative contracts requiring contingent future payments could not possibly be the equivalent of cash. Such contract rights had to be of an unascertainable value by their very nature. The lower courts were misled into believing that the question at issue was one concerning estimated value. The lower courts believed unascertainable value involved a valuation question.

It is more than likely that the error of the lower courts in the instant case is identified with issuance by respondent of Revenue Ruling 58-402, Cum. Bull. 1958-2, page 15 (Appendix B, infra, pp. 42-47). The Revenue Ruling emphasized that almost any asset could be valued, so that unascertainable value could only be found "in rare and extraordinary cases". The Ruling confounds problems of valuation with the real issue of whether receipt of particular property is the equivalent of cash for income tax purposes.

The obvious purpose of Revenue Ruling 58-402 is to discourage continued adherence to the long standing rule of *Burnet v. Logan*, 283 U.S. 404, 51 S. Ct. 550, so as to avoid possible capital gain treatment for payments received under speculative contract rights. The following paragraph of the Ruling so suggests:

> "Therefore, it is necessary (*Fleming v. Commissioner*, 153 Fed. (2d) 361), in order to prevent escape from the ordinary income tax by converting income payments into capital gains, to ascertain the value of the property in the prior sale or exchange and to close that transaction, except in rare and extraordinary cases. Otherwise, the ordinary income tax on the income collected from the contract or claim after the sale or exchange is converted into a tax on capital gains. Compare *Hurlbut W. Smith v. Shaughnessy*, 318 U.S. 176, Ct. D. 1575, C.B. 1943, 1144, stating that in a gift tax case involving a complex property interest created by means of a trust, even though concepts of property and value may be slippery and elusive, they cannot escape taxation so long as they are used in the world of business."

No case cited in Revenue Ruling 58-402, and no case relied upon by the lower courts in the instant case, actually decided the question of unascertainable value for property identical to speculative contract rights calling for indefinite and uncertain payments in the future. Instead, the cases cited involved property readily convertible into cash, if not the equivalent of cash, as an analysis of the citations would demonstrate.

In *Pat O'Brien, et al, Petitioners v. Commissioner*, 25 T.C. 376, cited in both the Revenue Ruling and by The United States Tax Court in its opinion in the instant case, the taxpayers were able to and did evaluate and report the fair market value of corporate assets received

in a liquidation, and the issue before the Tax Court was the taxable character of the payments received in excess of the taxpayers' own valuation at time of liquidation. The principal corporate asset was in process of being converted to cash.

In *Mace Osenbach v. Commissioner,* 17 T.C. 797, affirmed 4 Cir., 198 F. 2d, 235, 42 A.F.T.R. 355, cited in both the Revenue Ruling, and by The United States Tax Court in its opinion in the instant case, the taxpayers received in liquidation mortgages, notes, and other corporate assets that could readily be sold and liquidated for cash, and for which there was a market.

The case of *Commissioner v. Thompson,* 222 F. 2d 893, 47 A.F.T.R. 959, cited by The United States Tax Court in its opinion in the instant case, involved the valuation of a going business including assets and contracts susceptible of ready conversion into cash.

In *Albert Gersten, et al v. Commissioner,* 28 T.C. 756, cited by The United States Tax Court in its opinion in the instant case, there was a different type contract involved in that expert witnesses had testified that similar contracts were regularly bought and sold, so that there was a definite assurance the contracts were equivalent of cash.

In *May D. Hatch v. Commissioner,* 14 T.C. 237, cited by The United States Tax Court in its opinion, there was the case of valuation of an employment contract, involving final year income of a decedent, and for final year income purposes valuations are required to fulfill statutory requirements. (See *Hills Estate, et al v. Maloney,* 58 Fed. Supp. 164, 33 A.F.T.R. 479).

In *Warren v. U S.,* 171 F. Supp. 943, 3 A.F.T.R. 2d 1108, cited by The United States Tax Court in its opin-

ion, the United States Court of Claims completely disregarded the valuation factor, and decided the case on basis of income received from a property interest, contrary, incidentally, to a dissenting opinion. Also, in the *Warren* case, there had been a valuation of the overriding royalties in the year of sale, and capital gain reported on such basis.

In the case of *Frank Cowden, Sr. and Gladys Cowden, et al v. Commissioner,* 32 T.C. No. 73, The United States Tax Court specifically explained why the Court was not following the general rule, viz:

> " * * * In none of those cases were there findings of fact, as there are here, that the bonus payors were perfectly willing and able at the time of execution of the leases and the bonus agreements to pay such bonus in an immediate lump sum payment; to pay the bonus immediately in a lump sum at all times thereafter until the due dates under the agreements; * * * "

In somewhat like manner, in *Perry v. Commissioner of Internal Revenue,* 8 Cir., 152 F. 2d 183, 34 A.F.T.R. 560, the Court explained the type of property as to which a value could be ascertained for income tax purposes in the following language —

> "Under the statute property having a satisfactory ascertainable value, notes or bonds representing definite and fixed obligations, and securities marketable in the usual channels of trade when received in consideration for a sale of property are generally regarded, to the extent of the value of such items, as the receipt of cash and the transaction is considered closed for tax purposes in the year in which the sale is consummated. * * * "

Revenue Ruling 58-402 also relies substantially upon the decision in *Robert J. Boudreau v. Commissioner,* 5th Cir., 134 F. 2d 360. The Third Circuit Court of

Appeals in *Cassatt v. Commissioner*, 137 F. 2d 745, stated that the *Boudreau* case cannot be regarded as persuasive authority, because said decision " * * * failed to apply the rule laid down in *Burnet v. Logan*, 283 U.S. 404, 51 S. Ct. 550, 75 L. Ed. 1143."

Despite the misleading representations in Revenue Ruling 58-402, the long prevailing rule in court decisions has established that a contractual interest is not the equivalent of cash for income tax purposes, however it may be valued. Some direct quotations from court decisions should prove of substantial assistance.

In *Nina J. Ennis v. Commissioner*, 17 T.C. 465 (September 27, 1951), the Tax Court said —

> "In determining what obligations are the 'equivalent of cash' the requirement has always been that the obligation, like money, be freely and easily negotiable so that it readily passes from hand to hand in commerce. See *Dudley T. Humphrey*, supra, wherein we held that non-negotiable promissory notes are not the equivalent of cash and cf. *S. L. Meyer, Executor*, 23 B.T.A. 1201; *Harold W. Johnston*, 14 T.C. 560; *C. W. Titus*, supra; *Perry v. Commissioner*, supra. This principle was recently reiterated in the *Johnston* case wherein we held that a cash basis taxpayer realizes no income when he receives upon the sale of property a promise to pay contained in a contract of sale that 'merely requires future payments and no notes, mortgages, or other evidence of indebtedness such as commonly change hands in commerce, which could be recognized as the equivalent of cash to some extent, are given and accepted as part of the purchase price.'"

In *Curtis R. Andrews v. Commissioner*, 23 T.C. 1026 (March 15, 1955), the Tax Court said:

> "Petitioner relies on *Nina J. Ennis*, supra, wherein we stated that 'In determining what obligations

> are the "equivalent of cash" the requirement has always been that the obligation, like money, be freely and easily negotiable so that it readily passes from hand to hand in commerce.' The promise of petitioner's partner to make deferred payments to him aggregating $100,000 was embodied in the agreement terminating their partnership. Although accompanied by the guaranty of another individual, this was merely a contractual obligation."

Once again, in *Estate of Coid Hurlburt, Deceased, v. Commissioner,* 25 T.C. 1286 (March 21, 1956) the Tax Court stated:

> "The contracts did nothing more than evidence the amounts due the vendor over a period of years and as such can be regarded as little more than accounts receivable. The vendor was a cash basis taxpayer and he did not receive any notes, bonds, mortgages, or other evidence of indebtedness such as normally would be considered amounts realized by a cash basis taxpayer."

Even after the determination by the United States Court of Appeals for the Seventh Circuit in this (Chamberlin) case, The United States Tax Court in *Edward Allen LeVay, Jr. v. Commissioner,* T.C. Memo 1960-263 (December 8, 1960) stated:

> "Viewing the record as a whole, the only justifiable inference is that during 1955 these notes, entirely unsecured and non-interest-bearing, see Jay A. Williams, 28 T.C. 1000, were not equivalent to cash and had no ascertainable fair market value. They were hence not properly includible in the income of a cash basis taxpayer. K. E. Merren, 18 B.T.A. 156, 159, affirmed on other grounds (C.A. 5), 51 F. 2d 44 (10 AFTR 185); R. V. Board, 18 B.T.A. 650, 654; Virginia W. Stettinius Dudley, 32 T.C. 564, 590, affirmed per curiam (C.A. 2), 279 F. 2d 219 (5 AFTR 2d 1734)."

Only a decision of the United States Supreme Court can reaffirm the long standing rule that speculative contract rights have no ascertainable value for income tax purposes, because they are not the equivalent of cash. Only a decision of the United States Supreme Court can clarify any doubt on point that the long standing rule applies equally to all income tax cases.

The instant case presents both opportunity, and the need for such decision of the United States Supreme Court.

III. The United States Supreme Court by Deciding the Instant Case Will Dispel the Confusion and Will Terminate Continued Litigation on Matter of Whether the Estimated Value of Contract Rights Requiring Contingent and Uncertain Future Payments Has Any Bearing in the Treatment of the Receipt of Such Contract Rights for Income Tax Purposes.

In the instant case the Tax Court concluded that there is nothing inherent in a contract or claim for the future payment of indefinite amounts that causes it to be insusceptible of valuation. In so concluding the Tax Court necessarily concluded that the income tax issue was a matter of valuation per se. The Appeals Court affirmed the Tax Court decision. Any conclusion that the income tax question respecting contract rights for uncertain and contingent future payments depends upon the factor of valuation is in complete conflict with decisions of the United States Supreme Court and decisions in other tax cases.

As hereinbefore emphasized, speculative contract rights have an unascertainable value, because they are not the

equivalent of cash. Whether particular rights are, or are not, the equivalent of cash is not a question of value. Proof of an estimated value would not render speculative contract rights as having ascertainable value. On the other hand, proof of absence of value would not prove an unascertainable value.

As a matter of law contracts for future contingent payments are not the equivalent of cash, and hence are of unascertainable value for income tax purposes. The decision of the lower courts in the instant case missed this point completely.

In numerous cases value has been set aside in following the long standing rule that speculative contracts are not the equivalent of cash no matter what their value. Such contracts have an unascertainable value because of the very nature of the property, and not because of any evidence of value.

In *Burnet v. Logan,* 283 U.S. 404, 51 S. Ct. 550, the United States Supreme Court rejected a determination as to value by the United States Board of Tax Appeals of contract rights that had in fact been valued for estate tax purposes.

In *Willis R. Deering v. Commissioner,* 36 B.T.A. 843, the Board disregarded an actual stipulation of the parties as to the fair market value of the contracts, holding that such stipulation as to value did not make the contracts taxable.

In *Edwards Drilling Company v. Commissioner,* 35 B.T.A. 341, the Board held that the fact that contract rights had a fair market value did not require that the amount thereof be accrued as taxable income.

In *E. F. Simms v. Commissioner,* 28 B.T.A. 988, the Board disregarded the fact that the taxpayer had subse-

quently sold a contract for a substantial amount in determining that until sale the amount to be realized was uncertain and contingent.

In *J. Darsi Lloyd v. Commissioner,* 33 B.T.A. 903, the Board disregarded the readily determinable present value of a fixed annuity payable by a wealthy individual in deciding that the annuity contract had no value for income tax purposes when received.

In *George J. Lentz v. Commissioner,* 28 T.C. 1157, the Tax Court refused to accept a high factor of guesswork in deciding that the transaction be kept open until payments are received "thus allowing an accurate monetary valuation to be affixed to the rights".

There is complete uncertainty, confusion, and necessity for continued litigation where —

(a) Courts generally reject evidence of value as to speculative contracts in income tax cases, because such contracts are not the equivalent of cash, and are deemed to have an unascertainable value.

(b) The lower courts in the instant case presume to decide the question on a basis of value.

It is suggested that Revenue Ruling 58-402 has promoted the confusion. Before the Ruling was issued, the Tax Court in a case identical to the instant case stated:

> "* * * The net result was that these petitioners disposed of their stock for an unascertainable price equivalent to 120/1728ths of the royalties to be paid by Warner & Swasey Company. Those payments were amounts realized by the petitioners from the sale of their stock. Cf. Burnet v. Logan, 283 U.S. 404 (9 AFTR 1453)."

Lee H. Peck, et al v. Commissioner, 1952 T.C. Memo Decision 6/26/52.

In a case substantially similar to the facts here at issue, *Frank H. Hoy v. Commissioner*, T.C. Memo 1958-28, The United States Tax Court said—

> "There were a number of factors tending to make uncertain any forecast of the sums to be realized from the contract. It was dependent upon future production and sales by a company over which Hoy had no control. It depended upon the extent Globe would utilize the patents, which were principal factors in Hoy's business, but only a part of Globe's interests. It was uncertain whether competition or new inventions would depress the sales volume or render the products obsolete. * * *"

Only a decision of the United States Supreme Court can dispel the confusion, and terminate continued litigation. Only a decision of the United States Supreme Court can either reaffirm, or eliminate, the long standing rule that speculative contracts are not the equivalent of cash for income tax purposes.

IV. A Decision Of The United States Supreme Court Would Dispel The Conflict And Confusion Caused By The Lower Courts Holding In Another Issue In The Instant Case.

The instant case involves also the tax treatment of payments received by Marian Chamberlin from Borg-Warner under an exclusive patent license agreement. Mrs. Chamberlin claimed the payments should be taxed as long-term capital gains. The respondent determined the payments were ordinary income. Both the Tax Court and the Appeals Court sustained the respondent's determination.

The principal, if not the only, question as to this second issue in the instant case is whether reinstatement of an exclusive patent license agreement that had been cancelled for over eleven months constitutes a sale of the patentable interest. The Tax Court concluded as to this particular issue —

> "* * * The parties negotiated a settlement of the dispute without going to court and agreed that the original 'license agreement is in full force and effect and that any notices of cancellation heretofore given for alleged breach of contract were premature and ineffective'. In our opinion this would nullify the cancellation as effectively as though a court had declared it null and of no effect."

The Appeals Court affirmed the decision of the Tax Court as to this issue.

The lower courts completely ignored the long standing rule that cancellation of a license agreement completely divests the licensee of title. *Automotive Products Corporation v. Wolverine Bumper & Specialty Co., et al,* 15 F. 2d 745. It is not required that the licensor prove the claimed violation in court in order to render the cancellation effective. *National Pigments & Chemical Company v. C. K. Williams & Co.,* 94 F. 2d 792. Forfeiture of a license declared forfeited by breach of conditions cannot be overcome by a tender of royalties due. *Platt v. Fire Extinguisher Mfg. Co.,* 59 F. 2d 897.

With the exclusive license agreement cancelled, and the licensee divested of title during cancellation, it stands to reason that the reinstatement of the agreement after a lapse of many months effected an assignment of the title. Such legal conclusion follows even though, as the Tax Court concluded, the parties might end up in the same position they were before the agreement was cancelled.

The decision of the lower courts as to license agreement cancellation and reinstatement is obviously erroneous, and in conflict with decisions of other appeals courts.

Independently of the error in legal conclusion as to contract cancellation, the Tax Court also ignored its own decisions in deciding the Borg-Warner payments issue. Such other decisions have held that payments received by a taxpayer in settlement of litigation are entitled to the same taxable character that would have resulted had the litigation been concluded. *Rose Marie Reid v. Commissioner*, 26 T.C. 622. *Margery K. Megargel v. Commissioner*, 3 T.C. 238. *Albert J. Goldsmith v. Commissioner*, 22 T.C. 1137.

Only a decision of the United States Supreme Court can dispel the conflict and confusion caused by the lower courts' decision in the instant case.

CONCLUSION

The Court of Appeals for the Seventh Circuit has made an erroneous interpretation as to income tax treatment of speculative contract rights that are not the equivalent of cash. The interpretation directly conflicts with a long standing rule established by the United States Supreme Court, and consistently applied in decisions of several United States Courts of Appeal, and consistently applied in decisions of lower courts. Transactions involving speculative contract rights occur daily, and can be said to total in thousands per year. These transactions involve both capital gain and other income tax considerations. The error can be said to cause confusion and indecision in literally thousands of instances so as to result in a complete flood of unnecessary litigation.

The Court of Appeals for the Seventh Circuit has made an erroneous interpretation as to a second issue in the instant case, which interpretation is completely contradictory to decisions of other Appeals Courts in patent cases, and contradictory also to decisions in other income tax cases. Again, only confusion and unnecessary litigation can result.

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted.

HARVEY W. PETERS
1308 North Prospect Avenue
Milwaukee 1, Wisconsin
Counsel for Petitioners

May 26, 1961

APPENDIX A

OPINION

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 13020 — SEPTEMBER TERM AND SESSION, 1960.

JOHN W. CHAMBERLIN and MARIAN McMICHAEL CHAMBERLIN, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 13021

JOHN W. CHAMBERLIN, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 13022

MARIAN McMICHAEL CHAMBERLIN, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Petitions for Review of the Decision of the Tax Court of the United States.

NOVEMBER 30, 1960.

Before DUFFY, KNOCH and CASTLE, *Circuit Judges.*

DUFFY, *Circuit Judge*. These three petitions for review involve deficiencies for personal income taxes for the years 1947, 1948 and 1949. One case involves personal income tax liability of husband and wife who filed joint returns for 1948 and 1949. The second case involves the income tax liability of the husband who filed an inindividual return for 1947. The third case involves the income tax liability of the wife who filed an individual tax return for 1947.

In 1933, a patent was issued to taxpayer John W. Chamberlin covering a cleansing machine he had invented. Rex Earl Bassett, Jr., was also issued a patent on certain improvements in washing machines. In 1935, Laundri-Matic Corporation received an exclusive license under the Chamberlin and Bassett patents. Chamberlin and Bassett each owned twenty-six shares of the authorized one hundred shares of capital stock of Laundri-Matic Corporation. As of July 17, 1936, the other stockholders and their holdings were Arthur A. Berard, twenty-four shares; J. C. Rowland, twelve shares and Don O. Scott, twelve shares. Sometime after February, 1935, and prior to July 17, 1936, twelve of Rowland's shares were purchased by Bassett's wife who, in turn, sold them to Scott.

On April 23, 1935, Laundri-Matic granted to Hydraulic Brake Company an exclusive, transferable license to manufacture, use and sell laundry machines covered by the Chamberlin-Bassett patents. The agreement could be cancelled by the licensee on sixty days' notice.

On July 17, 1936, Laundri-Matic assigned to Chamberlin the right to receive twenty per cent of all royalties accruing or thereafter paid to Laundri-Matic under the Hydraulic license, the payments to be made directly to Chamberlin by Hydraulic. Chamberlin acquired this

right in exchange for twenty of his twenty-six shares of stock in Laundri-Matic, and by an instrument that was consented to by all of the stockholders.

On December 4, 1937, Laundri-Matic assigned to Chamberlin the right to receive an additional six per cent of the royalties payable under the Hydrau'ic license. This was acquired in exchange for the six shares of his stock interest in Laundri-Matic. On December 7, 1937, Chamberlin transferred the twenty-six shares of stock to Laundri-Matic. On the same day, he assigned his six per cent interest in the royalties to his wife Marian. Laundri-Matic had few assets other than the right to receive royalty payments under the Hydraulic license. On August 10, 1936, Hydraulic assigned its right under the license to Bendix Home Appliances, Inc. and Bendix assumed Hydraulic's obligations under the license. Payments involved in the first and second issues were made by Bendix under this agreement.

On December 24, 1937, Chamberlin and Bassett formed the Chamberlin-Bassett Research Corporation (Research). Chamberlin and Bassett each owned four hundred shares of the stock in Research, and their wives each owned one hundred shares for a total of one thousand shares. Chamberlin and Bassett assigned to Research all their rights and interest in inventions and patents in the field of commercial laundry machines. Research also acquired title to patents owned by others.

In February, 1939, Research granted an exclusive license to manufacture and sell certain types of laundry machines to Borg-Warner Corporation, which agreed to pay Research a royalty for each machine sold during each year the license was in effect, with a minimum monthly royalty. The agreement provided it should remain in

force until the last patent covered by it should expire unless previously terminated as provided in the agreement.

By agreement dated March 13, 1939, Research sold and assigned to Chamberlin and Bassett each a 50% interest in and to all royalties thereafter accruing or paid by Borg-Warner under the Borg-Warner license.

On December 5, 1939, Marian purchased her husband's four hundred shares of Research stock, and in June, 1940, she purchased the five hundred shares owned by Bassett and his wife, thus becoming the sole stockholder of Research.

By corporate resolution adopted June 17, 1940, Chamberlin and Marian were authorized to sell any assets of Research. This was done during 1940 but Research was not formally dissolved. By the middle of 1941, only the "shell" of the corporation remained.

By assignment dated August 25, 1940, Chamberlin sold to Marian all rights to Research royalties which had or might thereafter accrue to him under the license agreement between Research and Borg-Warner, and whatever rights might revert to him or Research in the event the Borg-Warner license should terminate.

On February 28, 1942, Research and Marian, by letter, notified Borg-Warner of an intention to cancel the Borg-Warner license for default in payment of royalties and rendering certain statements called for by the license agreement. By letter dated March 24, 1942, Borg-Warner denied it was in default.

On April 22, 1942, Borg-Warner was notified that the license agreement was terminated. From this time until April, 1943, negotiations were conducted between Borg-Warner and the attorney for Marian, respecting the can-

cellation. On April 15, 1943, Marian acquired from Bassett his right to receive fifty per cent of the royalties. On April 17, 1943, the dispute with Borg-Warner was settled. Thereafter, all payments under the license were made directly to Marian.

The first issue is whether the payments received by Chamberlin from Bendix in the years 1947, 1948 and 1949 were taxable to him as ordinary income or capital gain.

Chamberlin received the payments by virtue of the agreement dated July 17, 1936, whereby Laundri-Matic assigned to him the right to receive twenty per cent of all the royalties accruing or thereafter paid by Hydraulic in exchange for twenty shares of his stock in Laundri-Matic. There is no evidence of Chamberlin's basis in the stock and no unrecovered basis is claimed by the taxpayer.

Chamberlin claims that under *Burnet v. Logan*, 283 U.S. 404, if the royalty interest he received in exchange for his stock in 1936 had no ascertainable value at that time, the transaction remained open; and under the doctrine of *Commissioner v. Carter*, 2 Cir., 170 F. 2d 911 and *Westover v. Smith*, 9 Cir., 173 F. 2d 90, the royalties received in later years are a part of the consideration for the sale or exchange of the stock and are, therefore, taxable as capital gain. However, the Commissioner argues that the rule in the *Carter* and *Westover* cases does not apply to this case unless it is clearly shown that the contract right to royalties had no ascertainable value in 1936, and that petitioners have failed to carry their burden of proving this. Rule 32, Rules of Practice, Tax Court, 26 U.S.C. (I.R.C. 1954) §.7453.

In Rev. Rul. 58-402, Cum. Bull. 1958-2 at 15, the Commissioner took the position that, "Contracts and claims to

receive indefinite amounts, such as those received in exchange for stock in liquidation of a corporation, must be valued for Federal income tax purposes except in rare and extraordinary cases."

It is quite clear that when a taxpayer makes a gain from the sale or exchange of a claim or chose in action, this is a capital gain; while if the gain results from collection of the claim or chose in action, this is taxable as ordinary income. *Osenbach v. Commissioner,* 4 Cir., 198 F. 2d 235.

The Tax Court was of the view that the taxpayer had the burden of proving that the exchange of stock was not a closed transaction because the contract had no ascertainable value. The Court held: "On the record before us, we are unable to make an affirmative finding that there was no ascertainable value of the contract right distributed to Chamberlin in exchange for his stock in 1936 or in 1937. There is nothing inherent in a contract or claim for the future payment of indefinite amounts that causes it to be insusceptible of valuation."

This decision to treat the payments as ordinary income rested on the fact that Chamberlin had failed to sustain his burden of proof to bring himself within the exception to the rule established by the *Burnet* and *Carter* cases, and to overcome the presumption of correctness of the Commissioner's determination. The only evidence to support the taxpayer's claim was the contract itself. Chamberlin argues that: " * * * an estimated value of contingent and uncertain contract rights will not suffice for purposes of determining taxable income, and that this type of transaction remains open until payments are actually received."

Chamberlin places his main reliance on the *Burnet* and *Carter* cases. In our view, neither of these cases supports

his position. In the *Burnet* case, the Court did not decide that contracts for indefinite payments generally have no ascertainable value, but decided that the many uncertainties there present might prevent the return of capital. At the time there were no statutes giving capital gain treatment. In a very recent case, the Ninth Circuit had occasion to examine the *Burnet* case, and said: "It seems obvious this decision does not lay down any general rule which must be followed in the case at bar in any and all events." *Gersten v. Commissioner*, 9 Cir., 267 F. 2d 195, 198. Furthermore, in the *Carter* and *Westover* cases, the parties had stipulated that the contracts had, in fact, no ascertainable fair market value.

The Tax Court concludes with the finding that: "We cannot conclude as a matter of either fact or law, on the basis of the terms of the license agreement alone, that the value of the right to receive a percentage of the future royalties to be paid thereunder could not have been ascertained in 1936 and 1937." We hold the Tax Court decided this issue correctly on the basis of the facts that were in evidence.

There is nothing about a contract providing for royalties from a patent which makes it impossible to value the rights received thereunder. Patents frequently have been valued for tax purposes. *Henry Hudson*, 39 B.T.A. 1075, 1095. In addition there is evidence that twelve shares of stock in the Laundri-Matic corporation were bought and sold within sixteen months prior to July, 1936. The sale price of the stock might very well have fairly represented the value in a proportionate interest in the sole asset of the corporation. Furthermore, there is evidence that rights to receive the Borg-Warner royalties were bought and sold throughout the years. If the parties could place a value on these royalties, they could just as easily have

placed a value on the Bendix royalties. On the basis of the evidence, there is no reason to believe that some of these were not arm's length transactions.

In our opinion, the Tax Court was correct in holding the royalties received by John W. Chamberlin in the years in question must be taxed as ordinary income.

The second issue is whether the payments received by Marian from Bendix in each of the years involved were taxable to her as capital gain or ordinary income. The six per cent interest in the royalties was transferred by Chamberlin to his wife as a gift. All the parties agree that the payments received by Marian were taxable to her on the same basis as they would be taxed to her husband. *Commissioner v. Hopkinson,* 2 Cir., 126 F. 2d 406. Therefore, the Tax Court was correct in holding the payments to Marian by Bendix were taxable to her as ordinary income.

The third issue is whether the payments received by Marian from Borg-Warner Corporation were taxable to her as ordinary income or capital gain. Marian attempts to create a sale or exchange of a capital asset out of the reinstatement of the agreement with Borg-Warner. In essence, her contention is that as sole owner of Research, she distributed to herself the ownership of the patent involved in liquidation of Research; that when the dispute arose she, as owner, canceled the contract, and when the dispute was settled and the contract reinstated, this was a new sale by her of the patent. Marian argues that inasmuch as she held the patent for more than six months, she was entitled to treat the amounts thereafter received as capital gain.

The commissioner claims that Marian's right to receive the royalties was a claim or chose in action, and there

being no sale or exchange thereof, the amounts received in satisfaction of the claim were ordinary income. *Osenbach v. Commissioner*, 4 Cir., 198 F. 2d 235.

The Tax Court found first, there was no clear evidence that the patent was ever distributed to Marian, and second, the settlement of the dispute did not amount to a sale or exchange.

There is no evidence that Research actually assigned the patent to Marian or that Research was ever completely liquidated. In fact, Research was a party to both the purported cancellation and the letter of April 17, 1943, settling the dispute. In the light of the evidence, this Court cannot say the finding of the Tax Court is clearly erroneous. *Wisconsin Memorial Park Co. v. Commissioner*, 7 Cir., 255 F. 2d 751. Without title to the patent, the agreement to reinstate the license could not qualify as a sale of a capital asset.

Marian argues that under principles of patent law, where a breach of a license agreement affects the entire consideration, the licensor has the right to rescind the contract. She says that the license was subject to a condition subsequent, the payment of royalties, and that when Borg-Warner failed to make the payments and she canceled the contract, she was reinvested with the full property rights. It appears from the evidence that the alleged breach was the failure to pay royalties and to make certain reports. Borg-Warner immediately replied that it had applied the withheld royalties against expenditures for which the licensor was liable and that the failure to make reports was only a technical violation. Marian, in effect, agreed to this when she signed the letter settling the dispute which stated: "We further agree that said license agreement is in full force and effect and that any notices of

cancellation heretofore given for alleged breach of contract were premature and ineffective." The only evidence to the contrary was that Marian attempted to sell the patent rights to other parties during the dispute.

Based on this evidence, this Court cannot say the finding of the Tax Court, that there was no sale or exchange, was clearly erroneous.

AFFIRMED.

A true Copy:
Teste:

.....

Clerk of the United States Court of Appeals for the Seventh Circuit.

JUDGMENT IN THE UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Wednesday, November 30, 1960

Before

HON. F. RYAN DUFFY, Circuit Judge
HON. WIN G. KNOCH, Circuit Judge
HON. LATHAM CASTLE, Circuit Judge

NO. 13020 JOHN W. CHAMBERLIN and MARIAN McMICHAEL CHAMBERLIN

NO. 13021 JOHN W. CHAMBERLIN,

NO. 13022 MARIAN McMICHAEL CHAMBERLIN,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitions for Review of a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decisions of the Tax Court of the United States entered in this cause on November 12, 1959, be, and the same are hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

ORDER DENYING PETITION FOR A REHEARING IN THE UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Chicago 10, Illinois

Monday March 20, 1961

Before

Hon. F. RYAN DUFFY, Circuit Judge

Hon. WIN G. KNOCH, Circuit Judge

Hon. LATHAM CASTLE, Circuit Judge

JOHN W. CHAMBERLIN and MARIAN McMICHAEL CHAMBERLIN
Petitioners,

No. 13020, 21, 22

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Review of a decision of the Tax Court of the United States.

IT IS ORDERED BY THE COURT that the petition for a rehearing of this cause be, and the same is hereby, Denied.

APPENDIX B

Statutes Involved

Sec. 22, Internal Revenue Code of 1939:

Sec. 22. *Gross income.*—

(a) *General definition.* "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income.

* * * *

(26 U.S.C. (I.R.C. 1939) Sec. 22(a)—1952 Ed., Volume 3, page 3296)

Sec. 117, Internal Revenue Code of 1939:

Sec. 117. *Capital gains and losses.*—

(a) *Definitions.*—

(a)(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not

include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(a)(2) *Short-term capital gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

(a)(3) *Short-term capital loss.*—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such loss is taken into account in computing net income;

(a)(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(a)(5) *Long-term capital loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such loss is taken into account in computing net income;

(a)(6) *Net short-term capital gain.*—The term "net short-term capital gain" means the excess of

short-term capital gains for the taxable year over the short-term capital losses for such year;

(a)(7) *Net short-term capital loss.*—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(a)(8) *Net long-term capital gain.*—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(a)(9) *Net long-term capital loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(a)(10) *Net capital gain.*—

(A) *Corporations.*—In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

(B) *Other Taxpayers.*—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. If the tax is to be computed under Supplement T, "net income" as used in this subparagraph shall be read as "adjusted gross income."

(a)(11) *Net capital loss.*—The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the sum allowed

under subsection (d). For the purpose of determining losses under this paragraph, amounts which are short-term capital losses under subsection (e)(1) shall be excluded.

(b) *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * *

(26 U.S.C. (I.R.C. 1939) § 117(a) and 117(b)—1952 Ed., Volume 3, page 3372) (original 1939 Internal Revenue Codes as Amended by

55 Stat. 698 (10/21/42 C. 619 Title I §150(a), (b), (c) and §151(a);

56 Stat. 844 (2/25/44 C. 210 Part J §8(d)(1); and

58 Stat. 236 (9/23/50 C. 994 Title II §210(a))

Rulings

Revenue Ruling 58-402, 1958-2 Cum. Bull. 15

Contracts and claims to receive indefinite amounts, such as those received in exchange for stock in liquidation of a corporation, must be valued for Federal income tax purposes except in rare and extraordinary cases.

Advice has been requested as to the treatment, for Federal income tax purposes, of indefinite amounts of income in respect of property consisting of a contract or a claim, for future payment of such income, acquired upon exchange of stock in liquidation of a corporation, as affected by ascertainment of value of such a contract or claim.

The gain from the sale or other disposition of property, as provided in section 111(a) of the Internal Revenue Code of 1939, shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain. The amount realized shall be the sum of any money received plus the fair market value of the property (other than money) received, as provided in section 111(b).

The amount of the fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. Section 39.111-1, Regulations 118; *Robert J. Boudreau v. Commissioner*, 134 Fed. (2d) 360. Whether value is ascertainable is a reviewable question of law. *Commissioner v. Swenson*, 287 U.S. 618, certiorari denied, 56 F. (2d) 544, Ct. D. 555, C. B. XI-2 184 (1932). Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, as provided in section 115(c) of the Code.

The question decided in the case of *Burnet v. Edith Andrews Logan*, 283 U.S. 404, Ct. D. 351, C. B. X-1, 345 (1931), was whether the income taxes asserted might be imposed upon capital rather than upon income, in view of the many uncertainties in that case regarding valuation of the contract to receive 60 cents per ton of iron ore to be mined. The contract had been valued for estate tax purposes, and the Government contended that capital could be recovered through apportionment of the subsequent annual payments as capital and income. (There were no provisions for capital gains in the Revenue Acts of 1916, 1917, and 1918 involved there.)

The Court of Appeals stated in part in that case, 42 Fed. (2d) 193, as follows:

> * * * Here we have the question of whether there was any gain. * * * all the attending uncertainties which exist here * * * might prevent the return of capital. * * *

The Supreme Court of the United States stated, in part, that the transaction was not a closed one, and respondent

might never recoup her capital investment from payments only conditionally promised. In that case there were many uncertainties, and it was necessary that the future payments made to the stockholders of the company amount to $1,942,111.46 before the petitioner would have a full return of her capital.

In that case the courts did not decide that contracts for indefinite payments generally have no ascertainable value, but decided that the many uncertainties there might prevent the return of capital, under the asserted method of determining income for purposes of the early Revenue Acts.

Similarly, the question whether certain contracts to receive indefinite payments had ascertainable value was neither argued nor adjudicated in the cases of *Commissioner v. Susan J. Carter*, 170 Fed. (2d) 911, and *Westover v. Agnes F. Smith*, 173 Fed. (2d) 90. The question decided there was a capital gains question and not whether value was ascertainable. *Pat O'Brien, et al., v. Commissioner*, 25 T.C. 376, 385-386, acquiescence in part C.B. 1957-1, 4. It was decided that, if such contracts have no ascertainable value, the sale or exchange remains an open transaction, and the later payments received are subject to the provisions for capital gains. See also *J. C. Bradford v. Commissioner*, 22 T. C. 1057, 1072, acquiescence published in this Bulletin, page 6. See further, *George J. Lentz v. Commissioner*, 28 T.C. 1157, acquiescence published in this Bulletin, page 6. Acquiescence in *Susan J. Carter v. Commissioner*, 9 T.C. 364, also is published in this Bulletin, page 6.

Examples of rare and extraordinary cases of property which properly is considered to have no ascertainable value are the following: *Robinette v. Helvering*, 318 U.S. 184, Ct. D. 1574 C. B. 1943, 1141, involving a certain contingent reversionary remainder; *Commissioner v. Edwards Drilling Co.*, 95 Fed. (2d) 719, affirming 35 B. T. A. 341, acquiescence C. B. 1939-1 (Part I), 11, where the greatly disturbed and uncertain conditions in an oil field rendered greatly uncertain that wells

drilled in the field on contracts would pay out; *Thomas J. Brant v. Commissioner*, 13 T. C. 712, acquiescence C. B. 1950-1, 1, where it was not ascertainable whether stockholders of a land company would ever recover their capital basis out of payments which might be made by the Mexican Government.

The results, for purposes of capital gains or ordinary income, are that if the sale or exchange remains an open transaction, because of unusual uncertainties with respect to valuations in rare and extraordinary cases, then the subsequent payments received under the contract will be subject to the appropriate capital gains provisions in the statute; but, if not, then the sale or exchange is a closed transaction, by reason of valuation of the contract or claim for indefinite amounts of income, and the subsequent payments in excess of basis received under the contract or claim constitute ordinary income. *Pat O'Brien, et al., v. Commissioner*, supra; compare *Mace Osenbach v. Commissioner*, 198 Fed. (2d) 235; also compare *Douglas Fairbanks v. United States*, 306 U.S. 436, Ct. D. 1391, C. B. 1939-1, (Part I), 260. Generally, when a taxpayer makes a gain from the sale or exchange of a claim or chose in action, if it is not a substitute for ordinary income, this is taxable as a capital gain; while if the gain results from the collection of the claim or chose in action, it is taxable as ordinary income. See *Osenbach v. Commissioner*, supra. But compare *P. G. Lake, Inc., v. Commissioner*, 356 U.S. 260, Ct. D. 1823, I. R. B. 1958-22, 26, relative to sales of oil payments.

Therefore, it is necessary (*Fleming v. Commissioner*, 153 Fed. (2d) 361), in order to prevent escape from the ordinary income tax by converting income payments into capital gains, to ascertain the value of the property in the prior sale or exchange and to close that transaction, except in rare and extraordinary cases. Otherwise, the ordinary income tax on the income collected from the contract or claim after the sale or exchange is converted into a tax on capital gains. Compare *Hurlbut W. Smith v. Shaughnessy*, 318 U.S. 176, Ct. D. 1575,

C. B. 1943, 1144, stating that in a gift tax case involving a complex property interest created by means of a trust, even though concepts of property and value may be slippery and elusive, they cannot escape taxation so long as they are used in the world of business.

There are many cases in which contracts to receive indefinite amounts of income have been valued for tax purposes. Corporate liquidation cases include *Pat O'Brien v. Commissioner, supra,* in which contract rights to share in expected receipts from showing of a motion picture were valued; *Fleming v. Commissioner, supra,* valuing the right to share in the oil to be gotten from producing wells, and others to be drilled in the same field; *Boudreau v. Commissioner, supra,* in which rights to share in oil to be produced and saved from certain property were valued.

Patent rights, dependent upon estimated prospective earnings or sales, have been valued in numerous cases, such as *Henry Hudson v. Commissioner,* 39 B.T.A. 1075, 1095-1099; *Heberlein Patent Corp. v. United States,* decided March 9, 1938, by the United States District Court for the Southern District of New York, not officially reported, affirmed on another issue, 105 F. (2d) 965; *S. Marsh Young v. Commissioner,* 2 B.T.A. 457, acquiescence C. B. IV-2, 5 (1925); *B. F. Sturtevant Co. v. United States,* 18 Fed. Supp. 28; *Hershey Manufacturing Co. v. Commissioner,* 43 Fed. (2d) 298.

Approximate valuations have been made in various tax cases, such as *Helvering v. Enright Estate,* 312 U.S. 636, Ct. D. 1500, C. B. 1941-1, 353, stating that accrued income of a decedent included the value of the services rendered by the decedent in a law partnership, capable of approximate valuation; see *Burnet v. Houston,* 283 U.S. 223, Ct. D. 328 C. B. X-1, 343 (1931); *Helvering v. Safe Deposit and Trust Co.,* 316 U.S. 56, C. B. Ct. D. 1552, 1942-1, 246; see *Commissioner v. Louis Sternberger Estate,* 348 U.S. 187, Ct. D. 1777 C. B. 1955-1, 450; *cf. United States v. Charles A. Ludey,* 274 U.S.

295, T. D. 4046, C. B. VI-2, 157 (1927); *Commissioner v. Estate of Pompeo M. Maresi*, 156 Fed. (2d) 929, affirming 6 T. C. 580, acquiescence C. B. 1946-2, 4. In the *Ludey* case, *supra*, involving depletion of mineral deposits, it was stated that Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion. In the *Safe Deposit and Trust Co.* case, *supra*, it was considered far better to make such a rough estimate as the data will permit than completely to ignore the realities of the situation because of the difficulties of evaluation.

Accordingly, the Service will continue to require valuation of contracts and claims to receive indefinite amounts of income, such as those acquired with respect to stock in liquidation of a corporation, except in rare and extraordinary cases.